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First National City Bank
Monthly Letter
Business and Economic Conditions

New York, April, 1956

General Business Conditions

THE business reports during March have been impressively strong. Rising prices in stocks and commodities, heavy demand for money, and pressure on the bond markets, together with indications from well-regarded surveys that business spending will expand further and that consumers are confident, all reflect heightened optimism and extension of the boom. Industrial activity and employment, in the aggregate and with allowance for seasonal fluctuations, hold about the same as in other recent months, for automobile output is curtailed and there are other instances of moderate slackening to offset moderate advances. With the spring selling season here, automobile operations are expected to hold steady during the next two or three months. In home building, the other main soft spot, evidence is accumulating that the decline has largely spent itself and that the trend is now sideways or slightly rising.

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Industrial activity has been nearly stable, at record or near-record levels, during the past six months. In that period some industries, including steel and many kinds of heavy goods, have lifted output further. Their orders have run steadily ahead of shipments and their unfilled orders have increased. In some other lines, including, in addition to automobiles, farm implements and synthetic textiles, the trend has been downward. Thus adjustments have been going forward, reflecting shifts of business and consumers' demand from one area to another.

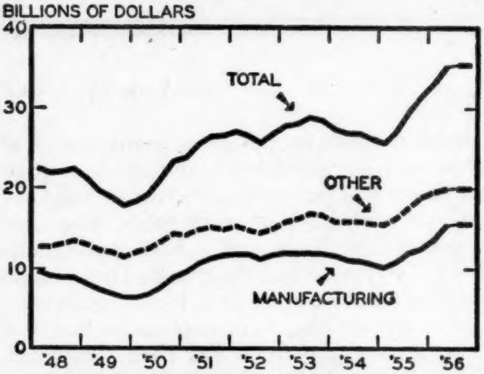
This is a healthy condition. After a long rise a point was reached where expansion could no longer be general, and where inventory accumulation or shifts of demand required adjustment. Business trends therefore are more diverse. The significant matter is that the adjustments are not falling concurrently, and that they are not causing any substantial slackening in over-all levels of activity. Offsetting movements have dovetailed so smoothly that over-all production is off less than 1 per cent from its high and nondurable goods manufacturing is at a new record. The steel industry has made the shift from a consumers' goods boom to a producers' goods boom without a hitch. Its best customer, automobiles, which in 1955 took nearly one fourth of finished steel shipments, cut weekly passenger car production 30 per cent between mid-December and the end of February. Yet steel mills continued near-capacity operations and in March set a new weekly output record.

Upswing in Capital Spending

Business men plan to spend nearly $35 billion on new plant and equipment this year, topping their record 1955 outlays by a startling 22 per cent. These figures were gathered in January and early February by the Department of Commerce and the Securities and Exchange Commission, and reflect a marked expansion in programs

since last fall. A McGraw-Hill survey, taken a few weeks after the President's heart attack, showed business at that time planning to boost investment 13 per cent during 1956.

Impressive as an upswing of 22 per cent sounds, it actually does not involve much further gain in the capital goods industries beyond that already experienced. The accompanying chart shows how rapid the advance has been during



Business Expenditures on New Plant and Equipment
Seasonally adjusted annual rates; first quarter 1956 preliminary, second quarter and second half based on anticipated spending.

the past year. In the first quarter of 1956, business men estimated that their capital outlays, at an annual rate of $33.2 billion, were 16 per cent above the 1955 average. In the second quarter, they anticipate a $35.2 billion rate of spending, 23 per cent above 1955. In the latter half of this year, new plant and equipment expenditures would have to rise less than 1 per cent over the second quarter rate to bring the 1956 total to the projected $35 billion. In fact, much of the initial impact of second half investment spending has already been absorbed by the economy. Large orders for heavy equipment have been placed, contracts for industrial and commercial construction have been signed, and in turn equipment manufacturers and contractors have placed orders with their suppliers.

Past experience tells us, however, that these preliminary capital spending plans are almost invariably underestimated. Since the latest surveys, President Eisenhower has decided to run again, consumer surveys have shown a high state of confidence and readiness to buy, and the stock market rise has pushed the Dow-Jones industrial averages above 500 for the first time in history. The decline in bond prices has raised the cost of borrowed capital, but if this causes deferment of some borrowing and some projects it is not likely to prove depressing, but only to reduce the pressures which are becoming so heavy. That is the way free capital markets work.

Confidence and competition are the chief influences in the high level of business investment. Many firms find modernization essential if they are to cut costs and remain competitive; those who have confidence in expanding and profitable business ahead realize the need to enlarge facilities or to branch out into new fields if they want to make the most of the broadening markets. The $5 billion or more spent each year on research and development provides a constant flow of investment opportunities in the form of improved processes and new products.

Consumers in a Buying Mood

Consumers are confident and have extensive buying plans for 1956, according to a survey conducted early this year for the Federal Reserve Board by the Survey Research Center of the University of Michigan. More people than ever before expect good times and an improved personal financial situation, while fewer anticipate bad times or expect to be worse off. Much of the optimism reflects rising real incomes. The number of spending units receiving $5,000 or more appears to have increased nearly 10 per cent in 1955 over the year before, bringing approximately 35 per cent of all consumer units into that income bracket.

The share of consumers intending to purchase homes, automobiles, furniture and appliances during 1956 is approximately the same as in 1955. Actually, these survey findings are not so much an estimate of the number of units of durable goods which will be sold this year as they are a clue to the current attitudes and anticipations of consumers. In 1955, far more consumers bought new cars than had planned to at the time of the survey. Repetition of this in 1956 is unlikely. Thus, the fact that the percentage of spending units planning to buy new cars in 1956 is the same as in 1955 (8.2 per cent) does not mean that auto sales this year will equal 1955. But the survey does show that consumers are not withdrawing from the durable goods market. Their buying interest is high; their confidence is greater than last year and so is their income. Most retailers will gladly settle for such a market.

It now appears that retail sales in the first quarter of 1956 may be somewhat lower on a seasonally adjusted basis than they were in the final quarter of 1955, although they are still ahead of the year earlier figures. Automobile sales have been lower than in the opening months of the model year, but the seasonal upswing appears to be getting under way. Gains in nonautomotive lines have not been sufficient to offset the lower rate of auto sales. Department and

apparel stores lost considerable sales volume when heavy snows blanketed the Northeast at the peak of the Easter season. However, over-all consumer expenditures in the first quarter are likely to hold close to the record fourth quarter rate because of the steadily rising trend of outlays on services.

Inventory Adjustments

In the process of adjustment, it would be expected that any weak spots in the inventory situation would have shown up. Whether it has been the result of caution and forbearance on the part of business men or sheer inability to stockpile materials in greatest demand, the current plateau has not revealed any conspicuous evidence of overstocking, except among the new car dealers. On the other hand, inventory accumulation appears to be slowing down; the $500 million rise in business stocks during January was somewhat less than the $700 million fourth quarter average.

The future course of inventories will be one of the main elements of the 1956 business pattern. A cutback in the record stocks of new passenger cars will be a necessity before new models are introduced early this fall. With or without a strike in the steel industry, stocks of some types of steel are likely to be worked off during the third quarter. Even textiles may not be exempt from another dip in their recurrent cycle, despite the good order position of many mills at present.

If this process of adjustment can continue without depressing the general business level it will be a feat almost without precedent. But the possibility that it will do so seems excellent. The underlying support comes from the immense demand for business plant and equipment and for non-residential construction of many types. Strength in these lines supports employment, and from them flows purchasing power — at rising wage rates — which sustains consumers' demands and employment in other industries.

The prospect of working out a readjustment at peak levels of activity is a gratifying one, but not without its perils. With production already bumping against capacity in key lines, there is little leeway for the increased spending plans announced by business, consumers, and government. Rising demand for manpower, materials, and money can facilitate increases in wages, prices, and interest rates, which soon spread around the economy. Wholesale prices have already inched up to the highest point in over four years, freight costs are up, and unions are preparing substantial wage demands for forthcoming negotiations. When economic resources are so nearly fully employed, it is only natural that some lines should face inflationary pressures at the same time that others are declining. It would not be surprising in the months ahead to see the physical volume of activity hold relatively steady, while economic measures in dollar terms rise along with the price level.

Bulging Credit Demands

The March drain on corporation cash balances from federal income tax payments, on top of increased working capital needs and record outlays for plant and equipment, produced unprecedented demands by business firms for loans from their banks. For the weekly reporting member banks of the Federal Reserve System, commercial, industrial and agricultural loans rose a phenomenal $1.4 billion during the first three weeks of March. Normally there is some increase in loans during March, but not of any such magnitude. Modest increases also appeared in other loan categories with the result that total loans of the reporting banks now show a rise of $1.2 billion (2½ per cent) since the year-end and of $8.2 billion (20 per cent) since one year ago.

Disproportionately heavy loan demands fell on major money market banks serving national corporations. The New York banks alone added $0.9 billion to their loan volume the first three weeks of March raising the ratio of loans to net deposits — which bankers use as a yardstick of the degree to which they are "loaned-up" — to 61 per cent. The ratio has not been this high since the early 1930's.

Loans, Investments and Deposits of Weekly Reporting Member Banks, New York and 93 Other Centers

	New York		93 Other Centers	
	Amount 3-21-56	Change since 3-23-55	Amount 3-21-56	Change since 3-23-55
Loans	$14.9 bil.	+2.8 bil.	$34.6 bil.	+5.4 bil.
Investments	8.8 bil.	—2.3 bil.	28.6 bil.	—3.8 bil.
Deposits	24.5 bil.	+0.1 bil.	69.4 bil.	+1.6 bil.
Ratio, loans to dep.	61%	+ 11 points	50%	+7 points

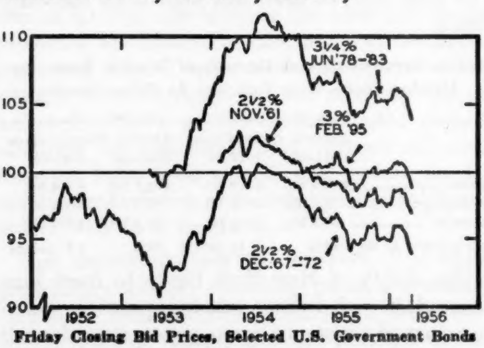
The ability of New York banks to meet loan demands in such volume was indispensably aided by renewed insistence upon appropriate deposit balances from customers enjoying credit lines, as well as by sales of investments earlier in the year to cover deposit losses and improve liquidity. Banks generally made somewhat greater use of the discount privilege at the Federal Reserve Banks. Bank borrowings from all twelve Federal Reserve Banks averaged about $960 million in March compared to around $800 million in January and February and the peak slightly beyond $1 billion in November.

Bonds Weaken

The increased needs of business for funds were reflected not only in bank loan demands but also in enlarged public offerings of bonds. Partly because so many life insurance companies and savings banks are giving first priority to mortgage investments, the market for corporate bonds quickly gave way under the weight of increased offerings. Underwriters of new corporate and also municipal issues found buyers in a mood to demand better yields and in some cases had to absorb considerable losses to place the securities. The congested market induced some borrowers to postpone offerings or cut down amounts sought.

Yields on new issues of corporate bonds rated Aaa or Aa by Moody's Investors Service moved up around 3⅜ per cent, where they had stood during the December peak of seasonal pressure on the money market; in February some issues of top grade had been placed at returns to the buyer as low as 3⅛ per cent. State and municipal bonds, affected by a swollen dealer inventory position, were marked down in price in order to attract buyers. Offered yields on new issues increased ¼ per cent or more to the highest level since 1953.

Treasury bonds also declined, in some cases to the lowest levels since 1953. The forty-year 3s slipped to 99, offering a yield to the buyer of 3.04 per cent. The Treasury 2½s due in 1961, only five and one-half years hence, traded at 97 to yield a buyer 3.07 per cent, the highest gross yield available on any Treasury security.



Friday Closing Bid Prices, Selected U.S. Government Bonds

Ninety-one day Treasury bills traded below 2¼ per cent during most of March in contrast to an average of around 2⅜ per cent in January and February. But this reflected the special influences of public debt retirement and Federal Reserve buying, rather than any easing of the money market. Finance company and commercial paper rates held around the 3 per cent level as borrowers used the opportunity to increase their offerings rather than to reduce rates.

The pressures of aggregate credit demand forced banks to confine loans to established customers and tighten credit standards. In many cases rates charged were raised. At the close of March rates on loans to brokers and dealers in securities generally advanced ¼ to 4 per cent.

Federal Reserve Policy

While some talk emerged of a possible increase in Federal Reserve Bank discount rates, the authorities took no action to indicate that they were disturbed by the pace of credit expansion. Federal Reserve Bank holdings of government securities were moderately increased during March; the tightened position of the banks was primarily a result of the flood of loan demands and the weakening market for bonds. It remained an open question at the end of March whether the Federal Reserve would see a necessity for a more actively restrictive policy.

Wage Inflation

A few days ago the *Wall Street Journal* carried this little news item on its front page: "Good Humor says its sales suffer in Los Angeles because, in that full employment area, it can't find enough drivers." The item actually points up a condition of over-full employment – more jobs than there are workers.

The labor situation confronting Good Humor ice cream vendors is matched in dozens of industries across the country. Although the shortage of skilled workers is more acute than that of non-skilled help, few workers have to hunt very hard for a job these days. In many instances they can take their pick of several jobs.

The government's monthly job tally tells the story. For the last year unemployment has been averaging 4 per cent of the civilian labor force. If we had figures on unfilled job requisitions, it is possible that they would show that there are more unfilled jobs than persons unemployed. Senator Paul Douglas of Illinois, in his 1952 book, *Economy in National Government*, suggested that a normal proportion of seasonal and transitional unemployment would run near 6 per cent. Wrote Mr. Douglas, an economist who has made a life-long study of employment statistics: ". . . For in a period when unemployment is less than 6 per cent, there is no real supply of workers ready to go into productive activity. Instead, the unemployed are primarily either the hard-core of the perennially unemployed, such as the handicapped, and the transitionally unemployed for whom job openings exist . . ."

When employers cannot find the help they need we have a condition of "over-employment."

Higher wages are paid to get help and increased costs are passed on in higher prices to the consumer. Trade union leaders press their advantage in contract negotiations. Employers are inclined to be generous because strike shutdowns are very costly when business order books are full. Thus over-employment builds up payroll costs and consumer demands beyond the productive power of the economy. Price inflation is the result.

People feel good when their incomes grow. The other side of the coin is rising prices. The expiration on June 30 of labor contracts in the steel industry is in the mind of all steel users. The union demands are variously estimated at anywhere from 32 cents an hour to as much as 49 cents an hour. Last year an average 15-cent-an-hour wage hike was accompanied by steel price increases averaging $7.35 a ton.

Institutionalized Inflation

The U. S. Steel Corporation, in its annual report released March 21, reviewed what has been going on under the heading of "institutionalized inflation." Citing what appears to be a "permanent and alarming peace-time trend of cost and price inflation", the nation's biggest steel producer reported its employment costs per employe hour between 1940 and 1955 showed an increase averaging 8 per cent a year compounded. When all other costs are included with the higher wages the average annual increase was 8.7 per cent compounded.

U. S. Steel went on to say that since it was impossible for output per employe hour to be increased at anything like these rates, it was necessary from time to time – as competition permitted – to raise steel prices and "thereby pass on to buyers of steel part of the underlying cost inflation." Prices of steel mill products increased 119 per cent between 1940 and 1955.

Getting down to the "two basic roots" of the "inflationary tendency" the big steel producer stated:

> The first one is the institution of industry-wide labor unions, headed by leaders who, with power to bring about industry-wide strikes, seek always to outdo each other in elevating employment costs in their respective industries. The legislative and social framework within which they function compels them to compete in elevating this basic cost.
>
> The other root is the Government's "full employment" policy under which the money supply must be inflated fast enough to accommodate the inflating employment cost, lest that mounting cost bring about its natural result of pricing some people out of their jobs, even though only temporarily. It takes ever more dollars to cover ever rising costs and prices if industry's full output is to be purchased. The money supply – people's bank deposits subject to check plus their pocket currency – was in 1955, on a per capita basis, 2.7 times what it was in 1940. This is equivalent to 6.8 per cent per annum compounded.
>
> The abuse of labor monopoly privilege and the monetary policy that transfers to the public in higher prices the penalty of that abuse appear to be the main elements of institutionalized inflation. It would be helpful in this regard if those responsible for determining wage costs and fiscal policies were constantly aware of the inflationary potentials of their decisions.

Britain's Plight

The problem is not unique with this country. It is acute in Great Britain where "full employment" has been pursued even more intensively than here. Just before World War II the British unemployment rate was more than 10 per cent, but since the war it has not risen above 3 per cent except for a few weeks in 1947. Now it is a mere 1 per cent of the labor force. The pound sterling has been losing internal buying power at an annual average rate of nearly 5 per cent since World War II. The British Government is seeking to arrest a tendency that destroys incentive to save and can only result in further devaluation of the currency and loss of international financial position and prestige.

On March 22, the British Government published a "White Paper" intended to acquaint Britishers with the basic problem of keeping prices down while maintaining full employment. The solution lies, the White Paper said, in self-restraint in making wage demands and in fixing profit margins and prices so that the total money income does not rise faster than output.

That has not been the case in Britain during the past 10 years. From 1946 to 1955, income from wages, salaries and profits rose 90 per cent while output increased only 30 per cent. Continued the White Paper:

> In the absence of such self-restraint, it may seem that the country can make a choice – albeit a painful one – between full employment and continually rising prices, or price stability secured with some danger to the level of employment that might otherwise have been achieved.
>
> But soon looms up the grim danger that the first of these apparent alternatives will turn out to have been no alternative at all because we may fail to secure sufficient imports to maintain full employment and our present standard of living.

The Public's Stake

Admittedly, Britain's problems are greater than ours. Still, it would be unwise to ignore that the incipient forces are present. It is everybody's concern. Labor leaders should avoid forcing wage hikes that outstrip productivity gains. Businessmen must do their best to pass on the benefits of increased output in the form of lower prices to the consumer. And Government monetary and fiscal authorities must realize that sup-

plying credit faster than increases in over-all output, in order to promote "full employment", is bound to result in climbing prices.

If labor, business and government do otherwise, there is a great risk that one day we will have to pay the penalty for puffing-up the economy. Warned U. S. Steel: "The hope that serious inflation and reactionary collapse may be avoided in the future lies in a widening public understanding of the new institutionalized cost inflation and in public endorsement of the monetary restraints needed to keep it from becoming explosive."

Corporate Earnings in 1955

Annual reports for the year 1955 now available from 3,400 corporations show combined net income after taxes of approximately $18.4 billion, compared with $14.6 billion in 1954. The increase of 26 per cent is unchanged from that indicated by our preliminary tabulation given last month covering some 2,400 companies. The number of companies reporting increases exceeds those having decreases in a ratio of three to one.

Among the main divisions of business, net income in manufacturing was up 31 per cent, mining 52, retail and wholesale trade 17, transportation 34, public utilities 15, amusements and service industries 16, banks and finance 7 per cent.

Large numbers of individual companies reported the highest net earnings in their history, while the combined total for all U. S. corporations practically equaled the previous peak in 1950, when earnings were swelled by booming demand and price inflation caused by the outbreak of the Korean war. Corporate income as a share of total national income, however, declined since 1950 from 9.2 to 6.7 per cent, while dividend payments declined from 3.8 to 3.5 per cent of national income.

Thus, last year's earnings, although generally favorable as compared with the best levels of the past, were by no means the highest on record when measured as percentages of invested capital or sales, both of which have expanded greatly during recent years.

Return on Assets and Sales

Net assets or net worth of all companies whose financial statements are now available aggregated $154 billion at the beginning of 1955, upon which the year's net income represented an average return of 11.9 per cent. This compares with an average return of 10.3 per cent on net assets of $142 billion in 1954.

Previous tabulations showed for the totals an average return of 13.3 in 1950 and a peak of 14.0 per cent in 1948. For the five years 1951-55 inclusive the annual average was 10.9 per cent, slightly below the average in the preceding five years 1946-50 of 12.0 per cent. For the years 1941-45 including World War II the average was 8.5 per cent, while in relatively depressed 1936-40 it was 6.4 per cent.

Since the book net assets, or excess of total reported assets over liabilities, are carried on the balance sheets in most cases far below present-day values, the rates of return thereon are correspondingly higher than if computed on the basis of actual replacement costs. These corporations, whose securities are widely held among investors and whose financial statements are published promptly, are representative mainly of the large and medium-size organizations in their respective lines and together comprise slightly over one-half of the net assets of all U. S. corporations, numbering 670,000.

Figures of sales or revenues, issued by most but not all the reporting companies, show increases over 1954 in a great majority of cases but in widely varying degree – reflecting the differing impact of the recovery from the business recession in 1954, the long-term economic growth trend, development of new products, and numerous other factors. Average margin of net income to sales or revenues for all reporting companies (excluding the banking and finance groups where sales volume is not a relevant item) was 6.8 per cent in 1955, compared with 6.1 per cent in 1954. These profit margins reflect income from investments and other sources as well as from sales.

Following is a condensed summary of the changes last year, while a more detailed tabulation by major industry groups is given on the next page.

Net Income of Leading Corporations for the Years 1954 and 1955

(In Millions of Dollars)

No. of Cos.	Industry Divisions	Net Income After Taxes 1954	Net Income After Taxes 1955	Per Cent Change	% Margin on Sales 1954	% Margin on Sales 1955
1,765	Manufacturing	$ 9,467	$12,373	+31	5.9	6.7
68	Mining	141	215	+52	7.2	10.2
187	Trade (ret. & whol.)	585	685	+17	2.5	2.7
233	Transportation	813	1,087	+34	6.7	8.3
268	Public utilities	1,922	2,216	+15	12.6	13.4
105	Amusements, services	178	206	+16	4.7	5.1
774	Banks and finance	1,510	1,614	+ 7	—	—
3,400	Total	$14,616	$18,396	+26	6.1	6.8

In most cases the percentage changes in the dollar totals of net income, which tend to fluctuate sharply from year to year, are less significant in measuring the trend of earnings than the ratios of net income to book net assets or to sales. This is particularly true when one of the

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1954 AND 1955

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1954	Reported Net Income After Taxes 1955	Per Cent Change †	Book Net Assets Jan.1-a 1954	Book Net Assets Jan.1-a 1955	% Return on Net Assets-a 1954	% Return on Net Assets-a 1955	% Margin on Sales-b 1954	% Margin on Sales-b 1955
19	Baking	$ 58,510	$ 57,853	+ 8	$ 467,569	$ 487,268	11.4	11.9	3.3	3.4
12	Dairy products	86,757	91,837	+ 6	698,787	755,165	12.4	12.2	2.5	2.5
14	Meat packing	29,117	58,828	+—	875,072	872,231	3.3	6.7	0.4	0.8
25	Sugar	27,548	31,999	+16	576,196	586,764	4.8	5.5	2.9	3.2
81	Other food products	281,468	303,319	+ 8	2,454,490	2,582,982	11.5	11.7	3.7	4.0
17	Soft drinks	42,998	50,926	+18	347,378	361,240	12.4	14.1	5.2	5.6
20	Brewing	26,605	21,575	—19	323,922	330,904	8.2	6.5	3.6	3.1
12	Distilling	72,539	73,031	+ 1	1,119,468	1,142,744	6.5	6.4	3.1	3.5
13	Tobacco products	139,578	163,067	+17	1,359,975	1,393,136	10.3	11.7	4.4	5.0
80	Textile products	81,699	191,098	+—	2,685,129	2,686,749	3.0	7.1	2.6	4.1
48	Clothing and apparel	20,858	29,244	+40	420,633	417,765	5.0	7.0	2.2	3.1
27	Shoes, leather, etc.	34,679	41,526	+20	339,981	359,383	10.2	11.5	3.2	3.5
30	Tires, rubber products	172,467	228,495	+32	1,446,998	1,509,705	11.9	15.1	4.2	4.5
27	Lumber	79,928	125,149	+57	821,239	883,400	9.7	14.2	6.9	9.1
20	Furniture, wood products	26,575	36,606	+38	279,126	291,515	9.5	12.6	4.5	5.3
76	Paper and allied products	347,418	417,625	+20	2,805,428	3,018,637	12.4	13.8	7.5	8.3
34	Printing and publishing	38,087	46,901	+23	348,662	362,708	10.9	12.9	3.6	4.3
61	Chemical products	765,142	999,367	+31	5,301,952	5,636,777	14.4	17.7	8.9	10.0
24	Drugs and medicines	118,017	153,620	+30	798,810	840,862	14.8	18.3	9.2	10.5
19	Soap, cosmetics, etc.	91,451	103,241	+13	615,053	646,854	14.9	16.0	5.0	5.3
19	Paint and varnish	71,560	92,231	+29	527,596	561,902	13.6	16.4	5.8	6.7
92	Petroleum prod. and refining	2,413,900	2,770,552	+15	17,529,562	19,488,977	13.8	14.2	10.7	10.6
32	Cement	89,190	110,146	+23	479,696	543,238	18.6	20.3	15.3	16.5
15	Glass products	124,014	170,885	+38	764,730	833,551	16.2	20.5	7.9	9.0
48	Other stone, clay products	143,957	194,647	+35	1,090,896	1,187,608	13.2	16.4	8.1	9.0
56	Iron and steel	636,688	1,094,872	+72	6,781,619	7,181,469	9.4	15.2	6.0	7.8
11	Agricultural implements	112,472	151,286	+35	1,627,710	1,710,880	6.9	8.8	4.4	5.2
75	Building, heat., plumb., equip.	118,173	140,375	+19	1,206,916	1,220,349	9.8	11.5	4.2	4.9
87	Electrical equip., radio & tv.	510,734	503,628	— 1	3,674,197	3,932,955	13.9	12.8	5.0	4.4
45	Hardware and tools	35,098	49,199	+40	432,808	459,396	8.1	10.7	4.8	5.7
39	Household appliances	55,215	65,541	+19	535,682	567,171	10.3	11.6	3.7	4.6
157	Machinery	243,937	262,414	+ 5	2,128,549	2,254,463	11.7	11.6	5.5	5.7
25	Office equipment	99,840	122,265	+22	677,532	725,464	14.7	16.9	6.6	7.0
41	Nonferrous metals	336,330	546,076	+62	3,107,586	3,263,405	10.8	16.7	7.3	9.5
49	Instruments, photo. goods, etc.	166,912	194,090	+16	989,900	1,098,294	16.9	17.7	7.2	7.8
95	Other metal products	186,694	226,509	+21	1,679,191	1,776,374	11.1	12.8	4.2	4.8
15	Autos and trucks	993,157	1,718,059	+73	5,522,359	5,897,223	18.0	29.1	6.4	7.4
64	Automobile parts	141,506	218,189	+54	1,357,708	1,422,538	10.4	15.3	4.2	5.3
23	Railway equipment	66,127	84,107	+27	907,330	938,173	7.3	9.0	4.1	4.7
41	Aircraft and parts	272,028	293,884	+ 8	1,002,900	1,187,752	27.1	24.7	3.8	3.9
72	Misc. manufacturing	108,156	139,055	+29	1,062,968	1,180,379	10.2	11.8	4.3	4.6
1,765	Total manufacturing	9,467,124	12,373,262	+31	77,173,288	82,598,845	12.3	15.0	5.9	6.7
21	Coal mining-c	12,565	40,961	+—	754,584	728,627	1.7	5.6	1.4	4.2
36	Metal mining-e	75,976	117,482	+55	762,264	856,666	10.0	13.7	9.3	13.4
11	Other mining, quarrying-c	52,473	56,546	+ 8	195,969	215,493	26.8	26.2	24.0	23.5
68	Total mining, quarrying	141,014	214,989	+52	1,712,767	1,800,786	8.2	11.9	7.2	10.2
25	Chain stores — food	85,580	94,738	+11	626,390	705,712	13.6	13.4	1.2	1.2
54	Chain stores — variety, etc.	111,325	144,284	+30	1,328,123	1,359,337	8.4	10.6	3.0	3.7
49	Department and specialty	151,230	176,085	+16	1,614,863	1,666,138	9.4	10.6	2.6	2.9
6	Mail order	177,182	202,180	+14	1,559,274	1,648,184	11.4	12.3	4.3	4.4
53	Wholesale and miscellaneous	59,961	67,801	+13	757,307	801,490	7.9	8.5	2.1	1.8
187	Total trade	585,228	685,033	+17	5,886,457	6,181,361	9.9	11.1	2.5	2.7
130	Class 1 railroads-d	681,690	925,067	+36	16,236,952	16,284,847	4.2	5.7	7.2	9.2
34	Traction and bus	19,537	19,909	+ 2	443,114	429,046	4.4	4.6	3.0	3.1
9	Shipping	16,631	29,696	+79	309,488	313,068	5.4	9.5	5.2	3.2
17	Air transport	64,830	73,735	+14	481,814	531,241	13.5	13.9	5.1	5.0
43	Misc. transportation	30,444	38,486	+26	298,767	314,836	10.2	12.2	6.1	6.9
233	Total transportation	813,132	1,086,893	+34	17,770,135	17,873,038	4.6	6.1	6.7	8.3
240	Electric power, gas, etc.-d	1,292,545	1,451,223	+12	13,600,649	14,718,398	9.5	9.9	13.6	13.9
28	Telephone and telegraph-d	629,042	764,572	+22	7,002,975	8,050,154	9.0	9.5	10.9	12.6
268	Total public utilities	1,921,587	2,215,795	+15	20,603,624	22,768,552	9.3	9.7	12.6	13.4
23	Amusements	51,168	56,719	+11	648,315	656,846	7.9	8.6	4.3	4.4
31	Restaurant and hotel	20,878	22,165	+ 6	175,854	192,030	11.9	11.5	3.5	3.9
36	Other business services	89,101	105,529	+18	577,315	656,645	15.4	16.1	6.9	7.4
15	Construction	16,769	21,599	+29	163,998	171,397	10.2	12.6	2.7	3.7
105	Total amusements, services, etc.	177,911	206,012	+16	1,565,482	1,676,918	11.4	12.3	4.7	5.1
362	Commercial banks	771,289	790,726	+ 3	7,509,949	8,159,383	10.3	9.7	—	—
67	Fire and casualty insurance	178,825	187,321	+ 5	2,555,319	3,421,165	7.0	5.5	—	—
195	Investment trusts-e	351,444	415,286	+18	5,857,665	7,855,304	6.0	5.3	—	—
76	Sales finance	189,854	203,156	+ 7	1,158,215	1,220,989	16.4	16.6	—	—
74	Real estate	18,545	17,327	— 7	164,676	172,188	11.3	10.1	—	—
774	Total finance	1,509,957	1,613,816	+ 7	17,245,824	20,829,029	8.8	7.7	—	—
3,400	Grand total	$14,615,953	$18,395,850	+26	$141,957,577	$153,728,529	10.3	12.0	6.1	6.8

a—Book net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent about nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures in most cases exclude capital gains or losses on investments. † Increases or decreases of over 100% not computed.

base years used for comparison is so low that a percentage change alone may be misleading.

In meat packing, for example, a group of 14 companies shows combined 1955 net income in dollars more than double that of '54 – reflecting mainly the unusually depressed conditions of the earlier year. The "doubling of profits" means a mere widening of the average profit margin, from 0.4 to 0.8 of one cent per dollar of sales, and improving the return on book net assets from 3.3 to 6.7 per cent – still less than half the average for "total manufacturing".

Because of the extreme variation in rates of capital turnover among different industries, wide profit margins do not necessarily mean high returns on the shareholders' investment, nor vice versa. A wide margin on a limited volume of sales may yield only a below-average return, whereas a narrow margin on a large volume may yield an above-average return.

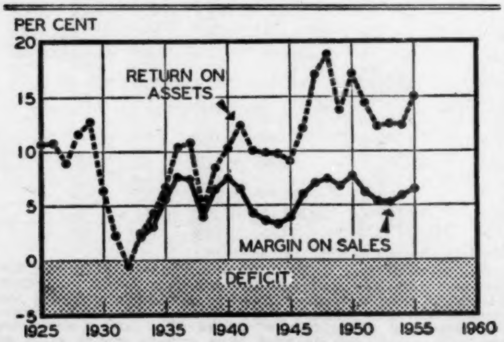
In railroads and public utilities, a large fixed investment is required and the annual operating revenues are usually less than the shareholders' equity; in other words, the capital is "turned over" not even once a year, and the rate of return is therefore less than the profit margin. Moreover, due to the large proportion of capital outstanding in the form of funded debt, the rates of return on total property investment would be lower than those shown on net assets alone.

Trends in Manufacturing

In the manufacturing industries, making up more than half of the total number of reporting companies and dollar figures in our tabulation, most groups show net income increases, in some cases quite sharp. Because of the accompanying increase in sales and net assets, however, average net profit margins and rates of return increased only moderately and in some cases decreased.

For the 1,765 manufacturing companies, the average net profit margin per dollar of sales plus other income widened from 5.9 cents in 1954 to 6.7 cents in 1955. On their combined book net assets the average rate of return rose from 12.3 to 15.0 per cent.

The longer-term trends of these two averages are pictured in the accompanying chart, based upon our annual tabulations of leading companies given in the April issues of this Letter.



Average Annual Net Profit Margins on Sales and Rates of Return on Net Assets of Leading Manufacturing Corporations

Pending Social Security Legislation

Among major pieces of legislation pending in the Congress is a House-approved measure (H.R. 7225) providing for broadening and liberalization of social security benefits, and boosting social security taxes. Though affecting the finances of almost every family in the nation, the new proposals have been more or less pushed into the background by the country's preoccupation with livelier matters such as the Presidential candidacies, international news, and the fight over farm legislation. Yet considering the nature of the proposals, their Democratic sponsorship, and the opposition of the Administration, the program has the makings of a hot campaign issue.

The bill is presently in the Senate Finance Committee, having been passed by the House in the closing days of the last session. It was introduced in the lower Chamber by Representative Jere Cooper, Democrat of Tennessee, chairman of the tax-writing Ways and Means Committee, on July 11. The committee, which – despite the importance of the changes proposed – held no public hearings, reported out the bill the next day, and six days later the House passed it by a thumping 372 to 31 majority, after only 40 minutes' consideration.

The Senate has moved more deliberately. The Finance Committee has just completed extensive hearings, and now plans to go into executive session starting April 9 to formulate its own recommendations. What happens will be influenced greatly by the degree of public understanding of what is involved, and by the extent to which such influence is brought to bear upon the Congress.

What the Bill Calls For

Briefly, what is involved in the bill as it stands is a sweeping liberalization of the benefit features of the Federal Old Age and Survivors Insurance system, affecting both government pensions and private pension plans – the latter generally geared to present social security benefits, retirement age, and other provisions. In addition it represents a radical departure from the old age insurance system, as heretofore conceived, and calls for an excursion into the broad and perilous field of general disability insurance.

The following summarizes the major provisions:

1. Insured workers who have become totally and permanently disabled to receive social security benefit payments at age 50. The present age requirement is 65.

2. Working women, wives and widows to become eligible for social security benefits at age 62 instead of the present 65.

3. Disabled children to continue to receive benefits after they reach age 18; under present rules benefits stop at 18.

4. Coverage under the program to be extended to about 200,000 people. This would include lawyers, dentists, osteopaths, chiropractors, veterinarians and the like – all presently excluded self-employed groups except physicians.

These changes would, it is estimated, add in the first year more than one million women and disabled workers to the rolls for Old Age and Survivors Insurance pensions at a cost of some $600 million annually in social security benefits. Eventually the cost of the expanded benefits is estimated to rise to $2 billion a year, or even higher.

To finance the costs of the liberalized benefits it is proposed to increase social security taxes by 25 per cent or $1.7 billion annually.

The following table gives the Ways and Means Committee's actuarial estimates of the impact of the new proposals on tax collections, benefit payments, and the social security trust fund. It should be pointed out that the Social Security Administration has a different set of estimates under the present law, and that all projections of this kind have had to be revised from time to time to conform to changes in birth rates, longevity, and employment levels. Hence, the accuracy of such projections is problematical.

Social Security Taxes, Benefit Payments, and Trust Fund Balance

(In Billions of Dollars)

Calendar Year	Contributions	Benefit Payments	Balance in Fund
Under Present Law			
1956	$ 6.8	$ 5.8	$ 23.2
1957	6.9	6.3	24.3
1958	6.9	6.7	24.9
1959	7.0	7.1	25.3
1960	8.5	7.5	26.7
1970	13.6	11.9	40.5
1980	17.5	16.0	69.9
1990	18.7	19.6	88.2
2000	20.4	21.1	99.1
Under Proposed Law, Assuming January 1, 1956 Effective Date			
1956	$ 8.2	$ 6.4	$ 24.0
1957	8.6	7.0	26.1
1958	8.7	7.6	27.7
1959	8.8	8.1	28.8
1960	10.3	8.7	30.9
1970	15.6	13.7	50.4
1980	19.7	18.2	88.7
1990	21.1	21.9	105.7
2000	23.1	23.6	128.0

According to the Committee table, under both the present and proposed law social security benefit payments will by 1990 begin to exceed substantially social security tax collections.

The social security trust fund, represented by special issues of U.S. Government securities, is estimated, however, to continue to grow after 1990 – despite the excess of payments over receipts – because of interest paid on the securities in the fund.

Heavier Tax Burden

The political attractiveness of the benefit proposals is obvious – especially in this election year. What politician running for office wants to risk voting against helping disabled workers and children and allowing women to quit work at an earlier age! A closer look at some of the provisions, however, suggests that lawmakers in the Senate might well weigh their action carefully.

First there is the question of the taxes workers and employers will have to pay.

Right now a worker and his employer must each pay 2 per cent on the first $4,200 of the worker's annual income. Self-employed workers pay 3 per cent. Under the House-passed bill, these rates would go up to 2½ per cent each for the employer and employe, and to 3¾ per cent for the self-employed.

These rate increases would be superimposed on those already scheduled under existing law for 1960, 1965, 1970 and 1975. By 1975 the employer and the worker would each be paying a 4½ per cent tax, while the self-employed individual would be paying 6¾ per cent. That compares with 4 and 6 per cent in 1975 under present law. Originally, the 1935 Social Security Act started with rates of employer and employe contributions of only 1 per cent each on the first $3,000 of annual earnings.

The impact of these taxes, particularly on low-income individuals, was brought out in the Minority report of the Ways and Means Committee last year. Take, for example, a farmer – or other self-employed person – with income of $4,200 in 1975. Assuming he has a wife and two children and takes the standard 10 per cent deduction, his federal income tax bill, under present rates, will be $276. His social security tax, on the other hand – which, unlike income taxes, is computed on income *before* exemptions and deductions – will under the proposed bill be $283.50, making a total income and social security tax load of $559.50.

Even more startling is the tax that would be imposed, under these assumptions, on a family

of four with income of only $2,000 a year – an income level that political leaders treat as the "poverty line". Such a family is exempt from income tax but would have $135 a year of social security taxes to pay under the proposal.

Marion B. Folsom, Secretary of the Department of Health, Education and Welfare warned not long ago: "There is a limit to the tax increases that should be imposed on the people to finance social security programs. We cannot provide every desirable benefit, or cover every possible need, without imposing a future tax burden on the people that might endanger public support for the system we are trying to uphold."

William G. Caples, vice president of Inland Steel Co. and chairman of the National Association of Manufacturers' committee on employe health and benefits makes this point: "Continuous liberalization of benefits for a minority of the covered people (such as those now retiring) will boost tax costs beyond the point at which the majority of the contributors (such as people under 40) can ever expect to get their money's worth for what they have paid."

All this is apart from the very large subject of changing the method of financing increasing benefits to a pay-as-you-go basis, as has been suggested by many. While the immediate effect would be to make possible a cut in present social security taxes, expanding benefit payments thereafter would require annual increases in rates. On such a basis the rising cost would be so much in direct evidence that perhaps there would not be so much pressure from the politicians for continually increasing benefits.

Disability Benefit Payments

A second major reason for a go-slow approach on the bill is the provision for payments to totally and permanently disabled persons at age 50.

In order to qualify for benefits, a worker would need to be fully insured under the social security program, and have worked half of the three years plus half of the ten years ending with his disability. These requirements are supposed to make sure the worker has been able and willing to work up to the time of his disability. Determinations of disability would be made by state agencies – mostly vocational rehabilitation agencies – according to standards set by the Federal Government. No benefit payments would be made until six months after the disability occurred; if a worker refused to accept rehabilitation he would find his payments suspended.

Backers of the provision advance the argument that present social security laws do not take care of an under-65 worker who is forced to retire because of disability. They should not, it is argued, have to go on relief until they are 65 and begin to draw from the system to which they contributed.

Such arguments have a strong human appeal, but other factors have to be taken into account. The real question is how disability aids can best be handled.

The present relief agencies are set up to cull out the fake cases from those which are genuine and to adjust benefits individually according to need. This is quite a different thing from administering pensions payable beginning at age 65. **To burden the Old Age pension system with the need to finance disability cases is to make it over into a duplicate relief agency and to give up the flexibility and adaptability to local conditions in the present federal-state relief systems.**

According to Robert J. Myers, chief actuary of the Social Security Administration, some 250,000 disabled persons would receive payments of $200 million in the first year of the program. In 25 years the number would, he estimates, rise to over 1 million and benefits to $860 million.

Estimates of future costs are tenuous, as pointed out earlier; it is impossible to prophesy exactly what will happen to the labor force, employment levels and disability claims. Costs, Mr. Myers admits, could be much greater if employment fails to remain high and government agencies do not strictly administer disability tests.

How costly this provision might be was brought out by private insurance company spokesmen in recent Senate Finance Committee hearings. These officials cautioned against moving the social security program into unexplored territory where costs could rise sharply and fraudulent claims would be difficult to resist. Many private insurance firms, it was brought out, suffered tremendous losses in fraudulent disability claims in the 1930s. Representative Noah Mason, Republican from Illinois, an opponent of the bill in the House, expressed his opposition, in part, as follows:

> . . . The unfavorable experience of private insurance companies with disability-income contracts can only be expected to be compounded when a disability program is administered by the Federal Government. Government employes, not under the necessity to operate the program at a profit and overly sympathetic to the public they serve, will find it difficult at times to deny benefits to individuals who may not actually be entitled to them under the law. This will make for higher-than-estimated costs, which will tend to grow still higher with time. . . .

An important question in calculating federal social security costs is the extent to which the disability program will have the effect of transferring some of the relief burden now carried by

the States and municipalities to the Federal Government. Since the States would determine who is "permanently and totally" disabled there is a strong probability of some of this relief being shifted to the federal level where there is likely to be less supervision.

Earlier Retirement for Women

A third section of the bill calling for particular scrutiny relates to lowering the retirement age from 65 to 62 for women workers, wives and widows.

On this provision, Ways and Means Committee Chairman Cooper presented estimates showing that an estimated 780,000 new beneficiaries would receive payments of $389 million in the first year of the program; by 1970 1.3 million women would receive more than $1 billion.

Supporters of this provision argue that a married couple should not have to get along on the same amount that is required for a single person. Since wives are generally a few years younger than their husbands, many retired couples must live on the husband's benefits until the wife reaches 65. A widow without children under 18, likewise, must wait until 65 before she can collect. Giving women workers the earlier retirement date was recommended by the Ways and Means Committee on the grounds that "age limits are applied more frequently to job openings for women than for men and the age limits are lower."

On the other hand, to extend benefits at a lower age to non-working wives and working women runs contrary to increasing life expectancy in this country. Whereas in 1900 there were about three million persons age 65 or older, about 4.1 per cent of the total population, today there are about fourteen million, about 8.5 per cent of the total. By 1975, experts expect there will be about twenty-one million citizens in this age bracket — nearly 10 per cent of total expected population.

A spokesman for Mutual Life Insurance Co. of New York told the Senate Finance Committee that in the 1940-52 period, there was an increase of 7.4 per cent in life expectancy at age 65 for men and a 12.5 per cent increase for women. These figures would appear to suggest that if any change is made in the retirement age it should not be a downward revision. National policies and programs should encourage, not discourage, the productive efforts of this growing segment of our population.

Another consideration is the effect of lowering social security retirement ages on private pension plans, which already cover some twelve million people. Most private plans follow the lead of social security in setting 65 as the quit-work time. If that age is dropped to 62, many qualified observers believe that private plans may have to follow suit. This would mean higher costs, and might lead to curtailment in expansion of such plans. State and local government retirement plans also would be affected.

Impact of Past Changes

The new proposals for revising the social security program come on the heels of numerous major changes adopted as recently as 1954. Among other things, those revisions extended coverage by about 10 million workers, increased benefit payments, and liberalized the retirement test by permitting beneficiaries to have earnings up to $1,200 a year without loss of benefits.

Administration spokesmen and some members of Congress have asked postponement of any further major revisions until a better assessment can be made of changes already on the books. For example, in 1954 Congress enacted the so-called "disability freeze" which protects the benefit rights of workers who become disabled. Since that program only recently got under way, Administration officials and others question whether there has yet been sufficient experience on which to base actual disability benefits.

The proposed changes, if enacted, would be the sixth set of major revisions in the Social Security Act since its original 1935 version. Coverage under the Old Age and Survivors Insurance program has more than doubled — from thirty-three million to seventy million persons.

Whereas as recently as 1949, only six out of ten jobs were covered under the program, now nine out of ten workers come under the social security "umbrella". Tax collections have increased tenfold, from $516 million in 1937 to more than $5.6 billion in 1955. About 8 million persons are now drawing benefits ranging from a minimum of $30 a month for a single retired worker to as much as $200 monthly for a family. Total benefits last year came close to $5 billion.

In view of the Presidential elections in the offing, the pressure for further liberalization of the benefits is bound to be heavy. The Administration and some Congressional leaders have been advocating extension of coverage and moderate liberalization of payments, but they have opposed the more sweeping and costly expansion provided in the House bill. Those who counsel moderation do not oppose a tax-supported security base for retired workers. They do advise against plunging the Federal Government deeper into a program involving unknown and mushrooming costs merely because of voter appeal.

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